

## **LEGAL REQUIREMENTS**

Agency loans are typically financed with tax-exempt revenue bond proceeds issued pursuant to Chapter 6.7 (commencing with Section 51325) of Part 3 of Division 31 of the California Health and Safety Code. Following are certain Federal and State legal requirements which apply to such loans. This is neither a complete listing nor a complete discussion of the applicable laws. Unless otherwise specified, "IRC Section(s)" refers to sections of the Internal Revenue Code of 1986, "Tax Regulation(s)" refers to Federal Income Tax Regulations, and "H&S Section(s)" refers to sections of the California Health and Safety Code. Occasionally Agency loans are financed with taxable revenue bond proceeds and in such cases the Federal IRC Sections and the Tax Regulations do not apply but the State H&S Sections still do. Often Agency loans are required to qualify for mortgage insurance under the HUD/FHA Risk Sharing Pilot Program pursuant to Section 542(c) of the Housing and Community Development Act of 1992, implementing regulations at 24 CFR Part 266 and current Handbook 4590.01.

### **A. PUBLIC HEARING AND APPROVAL (TEFRA):**

In accordance with IRC Section 147(f) and Tax Regulation 5f.103-2, the bond issue must receive the prior approval of the State Treasurer following a noticed public hearing (commonly known as a "TEFRA hearing"). The notice of hearing and approval must contain the following information with respect to the project: (i) a general description of its type and use; (ii) the maximum amount of bonds to be issued; (iii) the initial owner, operator or manager; and , (iv) its location. After the notice and approval, these facts may not be substantially changed prior to the loan closing.

### **B. ELIGIBLE PROJECTS:**

The project must qualify as "residential rental property" which is defined in IRC Section 142(d) and Tax Regulations as a building or structure, together with any functionally related and subordinate facilities, containing one or more similarly constructed residential units which (i) may not be used on a transient basis, (ii) are available to the general public, and (iii) satisfy the continuous rental and low income occupancy requirements discussed herein. Pursuant to IRC Section 145, if the borrower is a qualified 501(c)(3) nonprofit entity and the loan is financed with 501(c)(3) bonds, the project need not comply with the continuous rental and low income occupancy requirements nor with the land and existing property limitations discussed in paragraphs C.2(b), C.4 and C.5 below.

#### **1. RESIDENTIAL UNITS:**

Under the Federal rules, a residential unit consists of any accommodation containing separate and complete facilities for living, sleeping, eating, cooking and sanitation, which may be served by centrally located equipment such as air conditioning or heating.

An example of such a unit is an apartment containing a living area, a sleeping area, bath and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator and sink, all separate and apart from other apartments. The Internal Revenue Service has ruled that units (i) having no toilet facilities but having access to common sanitation areas, or (ii) containing only a "Pullman kitchen (containing a sink, cabinets, a small refrigerator, a hot plate with two burners) but having access to congregate eating facilities, did not satisfy this requirement.

H&S Section 51335(c) requires that lower-income units be of comparable quality and offer a range of sizes and number of bedrooms comparable to other units in the Project.

**2. FUNCTIONALLY RELATED AND SUBORDINATE FACILITIES:**

Facilities which are functionally related and subordinate to the residential units include recreational facilities which are available only to unit tenants and for which no charge in excess of actual cost of operation is assessed, parking areas for unit tenants, and other facilities which are reasonably required for the units (heating and cooling equipment, trash disposal equipment, and units for resident managers and maintenance personnel). In accordance with IRC Section 147(c), no more than 24.9% of the proceeds of any loan may be used for the acquisition of land.

**3. MIXED-USE BUILDINGS:**

In accordance with IRC Section 142(d)(1), in the case of buildings in which part of the space is used for commercial purposes and part of the space is used for residential purposes, that portion which is used for residential purposes may still qualify as residential rental property. As required by Tax Regulation 1.103-8 (b)(4)(v), the cost of the property benefiting both uses must be reasonably allocated between such uses. No more than 20% of the gross floor area, or 10% of the gross income may be used for commercial purposes.

**4. PUBLIC USE:**

The project must serve or be available on a regular basis for general public use.

**5. LOW INCOME OCCUPANCY:**

**a. Occupancy:**

IRC Section 142(d)(1) requires that, for each bond issue, the Agency must elect to set aside, during the "qualified project period", either (e) 20% or more of the units in each project for occupancy by tenants having incomes of 50% or less of the area median gross income, or (ii) 40% or more of the units in each project for tenants with incomes of 60% or less of the area median gross income. Pursuant to Tax Regulation 1.103-8(b)(8)(v), occupants of a unit are not considered to be qualified tenants if all such occupants are students (as defined under Section 151(e)(4) of the 1954 Internal Revenue Code), no one of whom is entitled to file a federal joint return under Section 6013 of the 1954 Internal Revenue Code.

H&S Section 51335(a)(1) requires that not less than 20% (15% in a targeted area) of the units in the project must be set aside for occupancy by lower income households (income not exceeding 80% of area median) and not less than 1/2 of those units must be set-aside for very-low income households (income not exceeding 50% of area median).

**b. DETERMINATION OF INCOME:**

The determination of income status must be made in accordance with Federal Section 8 rules with an adjustment for family size. (Reference: Tax Regulation 1.103-8(b)(5)(ii).)

**c.      QUALIFIED PROJECT PERIOD:**

The "qualified project period" as defined in IRC Section 142(d)(2)(a), means that period beginning on the date on which at least 10% of the units in the project are first occupied (or, if later, the date on which the bonds are issued) and ending on the latest of (i) the date that is at least 15 years after the date on which at least 50% of the units are first occupied, (ii) the first day on which not tax-exempt private activity bond issued with respect to the project is outstanding, or (iii) the date on which any assistance provided with respect to the project under Section 8 terminates.

**d.      ANNUAL CURRENT INCOME DETERMINATION:**

The determination of whether a tenant qualifies as a low-income tenant must be made annually. Pursuant to IRC Section 142(d)(3), an increase in a tenant's income or a decrease in a tenant's family size may disqualify such tenant if it has the effect of increasing the tenant's family income to more than 140% of the maximum. Because the continuing compliance requirement is not intended to cause the eviction of initially qualified tenants who no longer qualify, any resulting noncompliance with the set-aside requirement must be cured by renting the first available unit of comparable or smaller size to a qualified tenant.

**6.      RENTS:**

H&S Section 51335(a)(1) requires that the rents on the very-low income units (excluding any supplemental rental assistance from State, Federal, and local government) shall not exceed 30% of 50% of area median income. Programmatically, rents on lower income units are limited to 30% of 80% of area median income. The base rents must be adjusted for household size.

**7.      CONTINUOUS RENTAL:**

Under the Federal rules, all of the units in the project must be available for rental on a continuous basis for at least the "qualified project period". This means that the project may not be converted to condominium or other individual unit ownership during this period. Pursuant to IRC Section 143(k)(9), however, a limited equity cooperative housing corporation may elect to be eligible for tax-exempt financing as a multifamily project.

**C.      PROJECT OPERATOR ANNUAL CERTIFICATION:**

IRC Section 142(d)(7) requires that the operator of a project submit to Treasury an annual certification evidencing compliance with the low-income occupancy requirement. The failure to make timely reports subjects the operator to a \$100.00 per day fine.

**D.      REFINANCING:**

There are a number of Federal rules which prohibit the use of tax-exempt bond proceeds to refinance an existing development. (Reference: IRC Section 147(a) and Tax Regulations 1.103-

8(a)(5).)

**E. REHABILITATION EXPENDITURES:**

IRC Section 147(d) prohibits the use of tax-exempt bond proceeds to acquire existing property, however, an important exception is made for certain substantial rehabilitation expenditures.

**F. LOCAL AGENCY CONTRIBUTIONS:**

H&S Section 51335(a)(2) requires that the local agency issuing permits for the project must consider opportunities to contribute to the economic feasibility of the units and to the provision of units for very-low-income households through various specified concessions and inducements.

**G. LOAN PRIORITY:**

The Health and Safety Code (section 51335(a)(2)) requires that the Agency's mortgage have priority over any covenant, condition, restriction, or other limitation or agreement (other than the CHFA Regulatory Agreement) imposed on the project as a condition of qualifying it for any development, construction, or rehabilitation permit or approval or for any financial assistance.

**H. ARTICLE XXXIV COMPLIANCE:**

This article of the California Constitution requires that local voter approval be obtained before a state public body may develop, construct or acquire a low rent housing project. The cases of CHFA vs. Elliot (1976) 131 Cal. Rptr. 361 and CHFA vs. Pattitucci project (1978) 148 Cal. Rptr. 875, indicated that CHFA-financed projects which are: (1) not privately owned, or (2) exempt from ad valorem property taxes, or (3) in which more than 49 percent of the units will be occupied by lower income tenants, may be subject to Article XXXIV. The Agency loan commitment is subject to the condition that the project must comply with Article XXXIV, if applicable.

**I. SYNDICATION:**

H&S Section 51335(f) permits the syndication of the development upon the satisfaction of certain specified requirements and the written approval of the Agency. The Agency may grant that approval only if the terms and conditions of the syndication comply with certain specified requirements.

**J. PRIORITIES:**

H&S Sections 51335(a)(5) and (c) and (d) require that the certain specified types of developments receive priority treatment.

**K. REGULATORY AGREEMENT:**

H&S Section 51335(b) requires that the borrower enter into a recorded regulatory agreement with the Agency to implement the various legal and programmatic requirement which must be binding upon its successors in interest.

**L.**      **NON-DISCRIMINATION:**

H&S Section 51335(a)(3) prohibits any selection criteria to be applied to Federal Section 8 certificate holders that is more burdensome than the criteria applied to other prospective tenants.

Occupancy of the development must be open to all regardless of race, sex, marital status, age (except for elderly projects per California Civil Code Section 51.2 and 51.3), color, religion, national origin or ancestry. (Reference: Unruh Civil Rights Act (commencing with Section 51 of the California Civil Code).)

